Ellerston Australian MicroCap Fund

Investment Update – September 2017

Fund Facts

Investment Objective: To provide investors with long term capital growth via investing in a portfolio of quality Australian & New Zealand Microcap companies. The fund aims to outperform the S&P/ASX Small Ordinaries Accumulation Index over the medium to long term.

Benchmark: S&P/ASX Small Ordinaries
Inception Date: 1st of May 2017
Fund Size: $59mil
No. of Stocks: 56
APIR Code: ECL0984AU
Management Cost: 1.20% pa
Performance Fee: 20%
Investment Style: Growth at Reasonable Prices
Portfolio Manager: **David Keelan**
Senior Analyst: **Alexandra Clarke**
Suggested investment timeframe: At least seven years

Net Performance – For the period ending 30 September 2017

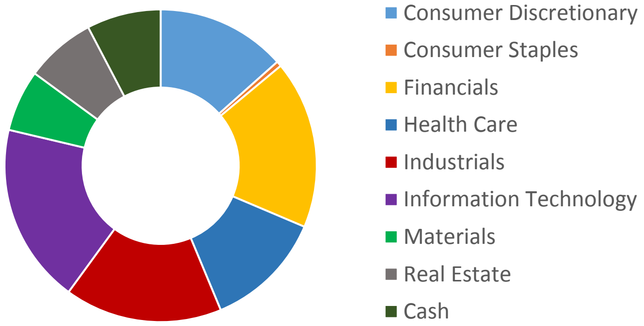
	Fund	Benchmark	Excess
1 Month	1.30%	1.30%	0.00%
3 Months	9.01%	4.41%	4.60%
Since Inception	20.53%	4.30%	16.23%

Past performance is not indicative of future performance.

Portfolio Characteristics

FY18	Fund	Benchmark
Price/Earnings	13.50	16.76
Dividend Yield	2.80%	4.00%
Net Debt/EBITDA	-0.45	0.90

Sector Allocation



Commentary

The Ellerston Micro Cap fund increased 1.30% net of all fees in September which was in line with the small ordinaries accumulation index which was up 1.30% also. The market in September was driven higher on the back of solid performance from resource stocks, consumer staples and financials. September was a great opportunity to catch up with our key holdings and meet with some potential new investments post reporting season in August. When we look at new investments, there are a number of key criteria which we would like to be met before we start accumulating a position. Nevertheless, what it really boils down to - is a company in charge of its own destiny or does it require external catalysts to ensure it can grow. With the volatility we are seeing in global markets we prefer companies that can drive growth by internal means (paying down debt with cash flow, changing funding cost etc.) or grow market share by innovation.

Two stocks which we like at the moment are Southern Cross Electrical and CML Group.

Southern Cross Electrical (SXE) historically was a contractor of choice for electrical works on resource projects in Australia and internationally, specialising in gold mines. In recent times, SXE has diversified through two strategic assets which has provided them with significant East coast electrical infrastructure exposure. We have followed this company for numerous years and it was pleasing to see how management have been able to pivot this business into other areas outside resources but remain within their core competency of delivering technically complex electrical solutions. Recently, we attended a SXE site visit where we saw work HeyDay was carrying out on a Sydney data centre as well commercial high rise. What this site visit demonstrated was the depth of management within the latest acquisition and how SXE's bigger balance will enable the group to reach its potential and grow strongly without being capitally constrained as a private business. SXE currently has a record order book of over A$470m and is well placed to fund working capital with its net cash balance sheet.

CML Group (CGR) is one of the largest non-bank providers of debt financing in Australia. It provides SME's working capital by using their receivables as collateral. This process is called factoring and CGR's role as a lender is disclosed to the client's debtors and the group assumes responsibility for the receivable management process.

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Given the labour intensive nature of the work, major banks choose not to compete in this segment therefore players like CGR and Scottish Pacific have reasonable market shares. Given the capital intensity of CGR's business model, the group historically funded its loan book growth through convertible notes and corporate bonds which have a relatively high interest rate and in recent times has secured much cheaper financing through an ANZ finance facility. Consequently, over time CGR will not only grow its loan book given the demand for these product but it will be able to start replacing higher cost debt with cheaper debt which will significant improve CGR's bottom line.

Effective as of 7 October, the Manager has determined that the current underwriting limit of 5% will be amended to 10%. The manager feels that from time to time, there may be a restriction on the opportunity set with the underwriting limit set at 5%, and a 10% limit loosens those restrictions and provides a wider mandate for opportunistic investments to deliver client outcomes.

Contact

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